

City of Detroit

OFFICE OF THE AUDITOR GENERAL



Audit of the Law Department

September 2005




Loren E. Monroe, CPA
Auditor General
City of Detroit

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MEMORANDUM

DATE: March 10, 2006

TO: Honorable City Council

FROM: Loren E. Monroe
Auditor General 

RE: Audit of the Law Department

C: Mayor Kwame M. Kilpatrick
John E. Johnson, Corporation Counsel

Attached for your review is our report on the Audit of the Law Department.

This report contains our audit purpose, scope, objectives, and methodology; background; status of prior findings; our audit findings and recommendations; other noncompliance issues; and the agency's response.

We appreciate the cooperation and assistance that we received from the employees of the Law Department.

This audit report and all other Auditor General reports can be obtained from our website at www.ci.detroit.mi.us/legislative/CharterAppointments/AuditorGeneral.

Law Department

September 2005

TABLE OF CONTENTS

	<u>Page</u>
AUDIT PURPOSE, SCOPE, OBJECTIVES, AND METHODOLOGY	1
BACKGROUND	2
STATUS OF PRIOR AUDIT FINDINGS	4
FINDINGS AND RECOMMENDATIONS	
1. Strengthen Internal Controls Over Imprest Cash	5
2. Strengthen Internal Controls Over Cash Receipts	7
OTHER NONCOMPLIANCE ISSUE	9
AGENCY'S RESPONSE	Attachment A

AUDIT PURPOSE, SCOPE, OBJECTIVES, AND METHODOLOGY

Audit Purpose

This audit of the Law Department was performed under the Office of the Auditor General's (OAG) charter mandate to audit financial transactions of all City agencies. The OAG performed an audit of the adequacy of internal control procedures for cash receipts, voucher disbursements, fixed assets, and imprest cash.

Audit Scope

The OAG performed an assessment of the Law Department's control procedures for cash receipts, voucher disbursements, fixed assets, and imprest cash transactions and determined there are certain weaknesses in the system of controls for the three-year period ended September 30, 2005. We focused our audit on the weaknesses discovered during the assessment, and the status of the prior audit findings.

Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, except for the completion of an external peer review of the Office of the Auditor General within the last three years.

Audit Objectives

Our audit objectives were:

- To evaluate the adequacy of the Law Department's internal controls over the major financial reporting processes;
- To determine whether the Law Department implemented the prior audit recommendations or otherwise resolved the findings; and
- To assess the Law Department's compliance with policies, plans, procedures, laws and regulations.

Audit Methodology

To accomplish the audit objectives, our audit work included the following:

- A review of City ordinances and other pertinent information relating to the Law Department;
- Interviews with Law Department personnel;
- Observation and testing of internal control processes and procedures for cash receipts, voucher disbursements, fixed assets, and imprest cash;
- A review and evaluation of contract terms; and
- Examination of a sample of transactions that we considered satisfactory to achieve our objective.

BACKGROUND

The Law Department is directed by the Corporation Counsel, who is appointed by the Mayor, subject to approval of the City Council. The duties and responsibilities of the Corporation Counsel, as set forth in the City Charter, include but are not limited to the following:

- Defend all actions or proceedings against the City;
- Prosecute all actions or proceedings to which the City is a party or in which the City has a legal interest;
- Prepare or approve all contracts, bonds, and other written instruments related to City operations, and
- Give legal advice or opinions upon request, and prepare or assist in the preparation of ordinances and resolutions.

The Law Department is comprised of five divisions:

1. Financial Management/Administration;
2. Governmental Affairs;
3. Labor and Employment;
4. Litigation; and
5. Property/Environment.

The Financial Management/Administration Division administers the Law Department's financial resources. These resources include oversight, management and disbursement of the Law Department's imprest cash, interagency billings, outside counsel contracts, and other departmental fees and costs.

The Governmental Affairs Division provides legal advice and representation to the Executive and Legislative Branches of the City government. The Division is comprised of three sections: Contract Section, Freedom of Information Section, and Municipal Section.

The Labor and Employment Division provides legal counsel and representation, proactive risk management, training, and timely and pertinent advice to City departments relative to diverse employment matters. The division enables City departments to minimize employee claims, disputes, and grievances and empowers City managers with information to foster and maintain better employee/employer relationships.

The Litigation Division provides support to City departments by minimizing financial exposure through risk management efforts, Alternative Dispute Resolution (ADR) practices, and defense and prosecution of litigation matters.

The Property/Environmental Division provides informed representation on environmental and real estate transactions, ownership, usage, and litigation issues.

The Law Department collects the following payments on behalf of the City:

- Freedom of Information Act (FOIA) fees;
- Delinquent accounts receivable;
- Delinquent property taxes;
- Subpoena fees;
- Claims of interest in bankrupted companies; and
- Reimbursable costs.

STATUS OF PRIOR AUDIT FINDINGS

In our previous report on the Law Department titled "Follow-up of Latest Audit Findings and Recommendations" dated September 1999, we reviewed six prior audit findings. We reported that of the six findings, two had been resolved; three were partially resolved; and one was unresolved. In this audit we reviewed the status of the four partially resolved and unresolved findings and determined the following:

Prior audit findings one and two, which identified weaknesses in the Law Department's cash receipts process remain partially resolved and are addressed in this report as finding two.

Prior audit finding three, which identified weaknesses in the verification of receipt of goods and services, was not repeated. In this finding, we reported that a lobbyist hired by the City is paid the same amount regardless of the level of services performed. We also reported that the Law Department paid for reference materials without evidence of receiving the materials. We have determined that the occurrences of these issues are isolated and the amounts are immaterial; therefore, we did not repeat this finding.

Prior audit finding four, which identified weaknesses in the Law Department's imprest cash process, was not repeated. In this finding, we reported that the Law Department had a significant number of nonvouchered items in its imprest cash accounts. We recommended that the Law Department ensure that an official receipt is presented to custodians within five working days after issuance of each imprest cash check. We also recommended that the Law Department comply with the City's Imprest Cash Manual by using receipts, instead of cancelled checks, for imprest cash reimbursement requests. Since the prior audit report, the Law Department obtained the Finance Department's approval to accept copies of cancelled checks as documentation to support certain imprest cash reimbursements. However, it is our opinion, that internal controls are weakened when copies of cancelled checks are used to verify purchases. Copies of cancelled checks do not ensure that items being reimbursed are the actual items purchased.

FINDINGS AND RECOMMENDATIONS

Based on our audit, we found that the Law Department's internal controls over major financial reporting processes were adequate with the following exceptions, which we reported as findings. Findings marked with an asterisk (*) indicate that the finding and related recommendation appeared in the previous Auditor General's report.

***1. Strengthen Internal Controls Over Imprest Cash**

The Law Department lacks adequate internal controls over its imprest cash fund. Our examination of the Financial Management/Administration Division found the following:

- The senior clerk responsible for reconciling the imprest cash fund is also the check writer of the fund.
- The imprest cash fund is not accurately reconciled to the bank statements on a monthly basis.
- The primary check writer of the imprest cash fund regularly distributes batches of 100 checks to himself without the custodian's authorization.
- Batches of blank imprest cash checks are maintained in an unsecured desk drawer.

The Finance Department's Schedule of Imprest Cash Responsibilities states the following:

- The reconciler of an imprest cash fund should be independent of all other imprest responsibilities; and
- Checking accounts must be reconciled with the bank statements monthly.

Furthermore, good accounting practices require the primary custodian of the imprest cash fund to maintain oversight of the imprest checks, which includes disbursing the checks and maintaining a signed check disbursement log.

Finally, the City's Finance Directive No. 20 requires departments to refrain from using envelopes, folders, unlocked desk drawers, cigar boxes or similar makeshift containers as cash receptacles and to replace them with locking cash boxes. Similar safeguards should be established for the security of blank checks.

Internal controls designed to safeguard the Law Department's imprest cash fund are weakened when the reconciler of the fund is not independent of other functions and duties of the fund. If other mitigating controls are compromised, errors and misappropriations could occur and remain undetected for long periods of time or indefinitely. Moreover, the lack of custodial oversight over the imprest checks increases the likelihood that checks might be mishandled and not properly disbursed or exposed to theft or loss if left in an unsecured area.

Although the Finance Department has provided some guidance to the Law Department on achieving proper segregation of duties, there still exists within the Law Department, a lack of understanding of internal controls over imprest cash. The Law Department staff stated that blank checks are kept in an unlocked drawer for convenience. In

addition, Law Department personnel lacks the training needed to properly reconcile the imprest cash bank statements.

Recommendations

We recommend that the Law Department strengthen internal controls over imprest cash and adhere to the Finance Department's imprest cash procedures and the City's Finance Directive No. 20 by accomplishing the following:

- Segregate the duties of the imprest cash fund reconciler from other functions or duties of the fund;
- Train selected staff to properly reconcile bank statements and reconcile the statements on a monthly basis; and
- Keep all unused imprest checks in a locked and secured location.

***2. Strengthen Internal Controls Over Cash Receipts**

The Law Department lacks adequate internal controls over its cash receipts. Our examination determined the following:

- During fiscal year 2004-2005, the Legal Advisors, Government Affairs, and Tax sections of the Law Department did not consistently deposit checks in the Treasurer's Office within 48 hours of receipt. We randomly selected ten checks from the cash receipts logs of the three sections. Of the ten checks selected, six were deposited more than 48 hours after receipt. The deposit dates of the four remaining checks, totaling \$219,214.84, could not be determined because the Tax Section did not retain copies of the Treasurer's deposit receipts, and the section's records were not adequate enough to determine deposit dates.
- The Tax Section of the Law Department does not record cash receipts promptly. Incoming checks are allowed to accumulate for several days before the Law Department staff records them in the cash receipts log, and issues receipts to the taxpayer.
- The Law Department sections that handle cash receipts do not perform an independent review of the cash receipts log to verify that cash receipts are deposited, according to the log of actual deposits in the Treasurer's Office.

The City's Finance Directive No. 20 states that cash should not accumulate. City departments should institute procedures to insure that all cash and checks are deposited in the bank within 48 hours after receipt. Furthermore, incoming checks are not properly safeguarded when they are not accounted for immediately upon receipt. Effective internal controls require that all incoming cash and checks be recorded in a mail register, cash register, or on a receipt form immediately upon receipt. An independent verification of the cash receipts log to cash deposits made to the Treasurer's Office, is a generally recognized method of providing assurance that cash receipts are deposited.

Failure to deposit cash receipts on a timely basis increases the risk of misappropriation or loss. Cash receipts that are not deposited promptly reduce the interest earned on deposited funds. Furthermore, if checks are allowed to accumulate and are not recorded in the cash receipts log when they are received, the Law Department has no record of an incoming check that may subsequently be lost or stolen. Moreover, the lack of a periodic independent reconciliation of cash receipts increases the likelihood of undetected errors, and misappropriation of cash receipts.

According to the Law Department staff, cash deposits are typically made once a week. Staff usually waits until several checks accumulate before depositing the checks at the Treasurer's Office. Staff also stated that instruction on the proper procedures for recording incoming cash receipts was not provided. Staff was unaware of the necessity to periodically reconcile cash receipts to cash deposits, and the general ledger.

Recommendations

We recommend that the Law Department deposit cash receipts within 48 hours of receipt in accordance with Finance Directive No. 20.

We also recommend that the Law Department implement the steps necessary to ensure that all incoming checks are accurately recorded immediately upon receipt and that appropriate documentation of cash deposits is retained.

Finally, we recommend that the Law Department immediately perform a reconciliation of its cash receipts log to ensure that cash receipts are deposited in the bank, and properly recorded in the general ledger. We also recommend that a staff person independent of the cash receipts process perform the reconciliation.

OTHER NONCOMPLIANCE ISSUE

In addition to the aforementioned findings and recommendations, we noted the following instance of noncompliance with established Finance Department policy:

Every City department receives a schedule date indicating when year-end reports must be submitted to the Finance Department. The Law Department did not submit its fiscal year 2003-2004 and fiscal year 2004-2005 year-end reports in accordance with the Finance Department's scheduled due dates. The City's year-end closing process is delayed when departments fail to submit their closing reports in accordance with the scheduled due dates.

We recommend that the Law Department implement procedures to ensure that all year-end closing reports are submitted to the Finance Department in accordance with the Finance Department's year-end closing schedule.

CITY OF DETROIT
LAW DEPARTMENT

CITY OF DETROIT

INTERDEPARTMENTAL COMMUNICATION

TO: Ms. Sharon L. Gipson
Interim Auditor General

FROM: John E. Johnson, Jr. *JEJ/Bmc*
Corporation Counsel

DATE: March 1, 2006

RE: **Auditor General's Report (Law Department Audit - September 2005)**

Please find attached the Law Department's response to the Auditor General's findings.

JEJ/bmc

Attachments

cc: Bessie M. McCants
Administrative Assist. II
Financial Management Unit (Law)



Ms. Sharon L. Gipson
Re: Law's Response to Audit

March 1, 2006

Page 2

Finding No. 1 - Strengthen Internal Controls Over Imprest Cash

Law Department's Response:

1. Corrective action has been taken and the Financial Management Unit (FMU) employees were advised verbally of the following: Principle Clerk #1 is solely responsible for check-writing of the Imprest Cash Fund. Senior Clerk #1 is the back-up check-writer and has been trained to write checks on this account. The Senior Clerk #2 is solely responsible for reconciling the Imprest Cash Fund (monthly bank statement). A monthly audit will be performed by the Administrative Assistant, Financial Management Unit (FMU). The Law Department will adhere to the proper segregation of duties as directed by the Finance Department and the Auditor General's Office.
2. Senior Clerk #2 had a problem with reconciling a bank statement in 2004. Training was provided and that problem has been resolved. The Imprest Cash Fund is currently being reconciled to the bank statement on a monthly basis within five (5) days of receipt.
3. An updated version of Quick Books will be installed (Spring, 2006) for handling bank reconciliations. Training will be provided by Law's Technical Support Specialist.
4. The distribution of blank checks to the primary check-writer has been corrected. Blank checks are issued by the custodian of the Imprest Cash Account or the alternate custodian. A Signed Check Disbursement Log is maintained for the distribution of all blank checks.
5. Steps have been taken to make sure blank checks are maintained in a secure locked area.
6. The Law Department is in compliance with Directive No. 20; all monies and/or checks are kept in a safe receptacle.



Ms. Sharon L. Gipson

Re: Law's Response to Audit

March 1, 2006

Page 3

Finding No. 2 Strengthen Internal Controls Over Cash Receipts

Law Department's Response:

Met with the Sr. Legal Supervisors/support staff (Legal Advisors, Government Affairs and Tax Sections) responsible for processing cash or check receipts. Reviewed procedures and informed staff verbally and in writing of the protocol for cash receipts procedures. Corrective action has been taken on the following:

1. All cash receipts will be recorded promptly into the Cash Receipts Log (date received, amount received, the name of the payer, description or purpose of the receipt, check number, and check deposit date). Entries will be initialed by the recorder.
2. Incoming checks will be deposited (in the Treasurer's Office) after forty-eight hours of receipt. Any checks not recorded into the log will be safeguarded until such time as they are recorded.
3. Sections will retain copies of the Treasurer's deposit receipts and maintain adequate records of those cash receipts.
4. Supervisors will review the Cash Receipts Log to verify that cash receipts have been deposited. Unannounced periodic audits of the Cash Receipts Logs will be performed by the Administrative Assistant, Financial Management Unit (Law Department). This method will provide assurance that cash receipts are deposited.
5. **ADVISED STAFF:** Avoid waiting several days before depositing checks. Cash receipts that are not deposited promptly reduces the interest earned on the deposited funds.
6. Finance Directives Nos.18 and 20 were distributed at the meeting.

Other Non-Compliance Issues:

The Law Department will adhere to the protocol (scheduled due dates) for submitting the year-end reports to the Finance Department.